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IN THE

Supreme Court of the United States

OCTOBER TERM, 1960.

No. 455.

COMMONWEALTH OIL REFINING COMPANY, INC.,

Petitioner,

against

THE LUMMUS COMPANY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT.

BRIEF IN OPPOSITION.

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October 28, 1960.

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BRIEF IN OPPOSITION.

Opinions Below.

The opinion of the Court of Appeals is reported at 280 F. 2d 915 and is printed in Appendix B to the Petition for Certiorari (pp. 37-69) and in the certified transcript (R. 7b).* The opinion of the Court of Appeals on Petition for Rehearing is also reported at 280 F. 2d 915 and is also printed in Appendix B to the Petition for Certiorari (pp. 70-74) and in the certified transcript (R. 89b).

The order of the District Court for the District of Puerto Rico, dated July 20, 1959, which was the principal order appealed to the Court of Appeals, is printed in the certified transcript (R. 331-46). No opinion was written

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*References in this Brief to the record and to the opinions of the Court of Appeals are made in the same manner used in the Petition for Certiorari (p. 2, note). References to "Appendix B" are to the Appendix to the Petition for Certiorari.

with respect to this order. The order, now moot, granting the first preliminary injunction is printed in the certified transcript (R. 304-13). The opinion with respect to that order is reported at 174 F. Supp. 485 and is printed in the certified transcript (R. 314-19). The opinion-order, also now moot, denying the motion to modify that injunction is reported at 175 F. Supp. 873 and is printed in the certified transcript (R. 327-30).

Questions Presented.

Petitioner's statement of the issues is unnecessarily convoluted and complicated. It distorts the real issues and seeks to create issues where none exist. In point of fact, the issues presented by this case are as follows:

1. (a) Whether the Court of Appeals was wrong in determining that the law of the State of New York was applicable in construing arbitration clauses embodied in contracts which were made, executed and delivered in New York, which recited that they should be "deemed to have been made, executed and delivered in New York," which provided for arbitration in New York, and which were executed by parties both of whom had their principal places of business in New York?

(b) Whether Petitioner was prejudiced by the application of New York law when no other law was cited to the District Court, when both parties consistently cited and relied on New York cases throughout the proceeding and when no significant difference was shown between New York and Puerto Rican law?

2. (a) Whether there was any impropriety in the determination of the Court of Appeals that both Puerto Rican and New York law require a party seeking to stay

an arbitration to show that there is a substantial dispute with respect to the making or existence of the arbitration agreement in order to obtain a plenary trial of that issue and an injunction *pendente lite?*

(b) Whether there was any impropriety in the determination of the Court of Appeals that the evidence before the District Court failed to show that a substantial dispute existed here?

3. (a) Whether the Court of Appeals erred in determining that no further evidentiary hearing was necessary in the District Court since Petitioner, after an ample opportunity to present evidence on all relevant issues, had failed to demonstrate that a "substantial dispute" existed with respect to the validity of the arbitration agreements?

(b) Whether the Court of Appeals erred in refusing to accept a tender of proof by Petitioner offered for the first time in support of the Petition for Rehearing in the Court of Appeals?

4. Whether, after determining that Petitioner had failed to raise a substantial issue with respect to the making or existence of the arbitration agreements, the Court of Appeals erred in instructing the District Court to stay further proceedings pending termination of the arbitration which the parties had agreed to conduct in New York?

Statement of the Case.

No effort will be made here to summarize in detail the facts contained in the 588 pages of printed record before the Court of Appeals or in the even larger record before the District Court. It is necessary, however, to correct some of the inaccuracies and omissions of Petitioner's statement.

The Contracts.

This litigation arose out of two contracts executed by Petitioner, Commonwealth, and Respondent, Lummus, whereby Lummus agreed to design and construct for Commonwealth a refinery and an expansion refinery. The two contracts were negotiated, executed and delivered in the State of New York (R. 291). Each contract contained the arbitration clause quoted in the Petition for Certiorari (p. 6) and each recited that:

> ". . . it . . . shall be deemed to have been made, executed and delivered in New York, New York." (R. 163, 176, 335).

At the time when the contracts were executed both Lummus and Commonwealth had their principal places of business in New York City (R. 109, 290, 294).

Commonwealth's statement in its Petition that the two contracts guaranteed the "performance and operability" (pp. 5-6) of the refinery and the expansion refinery is an oversimplification. It would, of course, be unusual indeed for the designer of a manufacturing plant, particularly one as complicated as an oil refinery, to guarantee that the purchaser of the plant would operate it successfully. No such guarantee was made here.

Because of the difficulty of otherwise defining the respective obligations of parties engaged in transactions as complicated as this one, each contract outlined in detail the guarantees made by Lummus and the procedure for determining whether those guarantees had been met (R. 164-70, 178-88). The effect of the guarantees was that Lummus obligated itself to construct facilities which would, during a designated acceptance-test period,* and under defined con-

* For example, the guarantees under Exhibit 10 of the original refinery contract were based on performance during any 24 hour period selected by Lummus out of a test run covering 24 to 120 hours (R. 165-66, 168).

ditions, produce from a particular crude oil a specified yield of products. Among the assumptions which formed the basis of the guarantees were the suitable operation of the facilities by an adequate number of competent personnel provided by Commonwealth (R. 164, 178) and an adequate and uninterrupted supply of utilities (R. 168, 183).

Each contract provided that, if the tests were conducted and the guarantees were not met, Lummus would make such changes in the refineries as were necessary to meet them (R. 161, 175). This provision further stated that:

> "Contractor's (Lummus') liability in respect to performance guarantees of the plant is expressly limited to the extent stated in this section." (R. 161, 175).

To make it clear that the obligations of both parties were limited to those defined in the contracts, paragraph 26.1 of each contract provided that all previous "figures, proposals and agreements" were cancelled and that no oral representation either before or after the execution of the contract would modify any obligation of either party (R. 163, 176).

Finally, each contract provided in paragraph 4.4 that if Lummus notified Commonwealth that it was ready to conduct acceptance tests and if Commonwealth failed to conduct the tests within 45 days and failed to pay the amount due to Lummus within that time "all obligations of the Contractor (Lummus) with respect to initial operations or acceptance tests or performance guarantees shall terminate and it shall be deemed that the Purchaser (Commonwealth) has automatically accepted the plant" (R. 159-60, 171-72).

Construction and operation.

Lummus proceeded to construct the two refineries. The design of the refineries was based on "well-known

processes commonly used by a number of oil companies" (R. 297). Crude oil was charged into the process units of the original refinery in January, 1956 (R. 193), and crude oil was first charged into the expansion refinery on about September 30, 1957 (R. 193-94).

Commonwealth has experienced difficulties of various kinds in operating some of the units of each refinery (R. 114-19). There are a multitude of possible causes for such difficulties. Neither the extent of the difficulties nor their possible causes have been fully explored in the present record. It was of course contemplated that questions of this kind would be explored in the arbitration upon which the parties agreed.

On at least two occasions the refineries' operations were interrupted by the first hurricanes to be experienced in Puerto Rico in 24 years (R. 101).*

One important factor is the care with which the facilities are maintained and the skill with which they are operated. In this connection it is significant that in February, 1957 extensive changes were made in Commonwealth's management (R. 109).

Acceptance tests.

Petitioner's statement that "respondent did not formally demand that petitioner conduct acceptance tests

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* The statement in the Petition that Petitioner had to expend $10,600,000 to place the refinery in an "economically operable condition" (p. 7) is not supported by the record. The record shows only that "upon completion" of a construction program designed "to achieve corrections, improvements and enlargements to the refinery" Commonwealth "will have spent" this amount. R. 60. The record does not show whether the expenditures were in fact made. It is also apparent that the expenditures were not necessary to put the refinery in an "economically operable condition." If Commonwealth had honestly felt that corrections were necessary to enable the refinery to meet the contractual guarantees, it could have, by agreeing to the conducting of acceptance tests, placed the burden on Lummus of making any such changes (R. 161, 175).

until November 11, 1958 . . ." (Petition, pp. 6-7) is misleading. Lummus first notified Commonwealth that it was ready to conduct acceptance tests under the original refinery contract in August, 1956 (R. 194). Commonwealth requested postponement of these tests because its commitments with respect to crude oil and products made it inconvenient for it to charge into the refinery the crude oil on which the guarantees were based (R. 194).

In January, 1958 the expansion refinery units were tested and passed certain Initial Operations Guarantees provided in Sections 10.2 and 10.3 of the contract of March 14, 1956 (R. 195). On February 3, 1958 the President of Commonwealth acknowledged in a letter to Lummus that these guarantees had been met (R. 214); thereafter, in May, 1958 he purported to revoke this acknowledgment (R. 250).

Shortly thereafter Lummus began preparations for a test run of the entire refinery and requested Commonwealth to do likewise (R. 196). Commonwealth had not since 1956 processed the crude oil mixtures upon which the guarantees were based (R. 196)* and it was therefore necessary for Lummus, at considerable expense, to formulate new guarantees based on the crude oil then in use by Commonwealth (R. 196). When Lummus had formulated these guarantees, Commonwealth advised that they were unacceptable, but did not specify any particular respect in which they were deficient (R. 196). Lummus also advised Commonwealth that the refinery had not been properly maintained and described maintenance work necessary to prepare it for tests (R. 196). On September

* There is of course a great difference in the composition of crude oils and in the products which can be obtained from them. Product guarantees must therefore be based on the use of particular crude oils or crude oil mixtures.

17, 1958 the parties held a meeting in New York at which Lummus pressed for the conducting of tests and Commonwealth resisted them (R. 197).

In order to cooperate in making acceptance tests possible at minimum cost and inconvenience Lummus offered to postpone the tests until after Commonwealth's first periodic shutdown for required maintenance or after the installation of a new process unit then under construction. This offer was refused by Commonwealth. When Commonwealth persisted in its refusal to conduct tests, Lummus demanded on November 11, 1958 that acceptance tests in accordance with each contract be conducted within 45 days. Again Commonwealth refused to conduct the tests (R. 197).

Commonwealth has thus frustrated every effort by Lummus to conduct the tests which are the only means of determining whether the contractual guarantees can be satisfied.

Commencement of litigation.

Commonwealth has withheld payment of $4,697,997.85 which it owes to Lummus for work performed and materials supplied in connection with the contracts (R. 17-18, 198). On April 29, 1959 Lummus demanded arbitration under its two contracts with Commonwealth of its claims against Commonwealth in this amount and of "any set-offs or counterclaims . . . which Commonwealth may assert" (R. 17-18). The demand for arbitration was admittedly received by Commonwealth on April 30, 1959. Under New York law arbitration is a "special proceeding" (N. Y. Civil Practice Act §1459); the special proceeding is commenced by the demand for arbitration.*

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* *E.g., Fay* v. *Phenix Soda Fountain Co.*, 153 N. Y. S. 2d 153 (Sup. Ct. Kings Co. 1956); *Shine's Restaurant, Inc.* v. *Waiters and Waitresses Union*, 113 N. Y. S. 2d 315, 317 (Sup. Ct. N. Y. Co. 1952).

On May 4, 1959 Commonwealth commenced an action against Lummus in the District Court for the District of Puerto Rico (R. 7, 335). At the same time Commonwealth moved in that Court pursuant to 32 L. P. R. A. §3204 (4) (a) for a stay of the arbitration which Lummus had demanded. Both the action and the motion for stay were based upon Commonwealth's allegations that certain studies and projections prepared by Lummus prior to the execution of the contracts were either fraudulently misleading or constituted negligent misrepresentations (R. 7-12).

Until the commencement of this suit on May 4, 1959 Commonwealth had in no way suggested that Lummus was guilty of fraud or that Commonwealth regarded the contracts between the parties or the arbitration clauses embodied in them as fraudulently induced or subject to rescission.

Indeed Commonwealth had consistently indicated until that time that it regarded the contracts as valid and subsisting and intended to rely upon them (R. 205-09). For example, on January 15, 1959 Mr. Manning, Secretary and General Counsel of Commonwealth, wrote to Lummus stating that:

> "We did not and do not mean that we think Lummus is released from any of its contractual liabilities to this company."

He went on to say that:

> " . . . you are not relieved of your obligation to perform the required services under the contract" (R. 261).

On May 20, 1959 Lummus served a petition, filed in the New York County Supreme Court, to compel arbitration. On May 25, 1959 Commonwealth filed in the United

States District Court for the Southern District of New York a petition for removal of Lummus' action pending in New York County (R. 337).

On the morning of May 29, 1959 counsel for Lummus advised counsel for Commonwealth that they would present that afternoon to the District Court for the Southern District of New York an order to show cause why Commonwealth should not be enjoined from any further proceedings in the action which it had instituted in Puerto Rico pending final disposition of the New York suit and would ask the District Court for a temporary restraining order pending a decision on the motion for injunction (R. 337-38). Commonwealth's counsel thereupon applied to the District Court in Puerto Rico, without notice to counsel for Lummus, for an order restraining further proceedings in the suit pending in New York. This restraining order was issued by the Puerto Rican Court within a matter of a few hours and the District Court in New York was advised of its issuance during the course of the hearing on submission of the order to show cause.

The temporary restraining order issued by the District Court in Puerto Rico on May 29, together with the subsequently issued orders described in the Petition for Certiorari, have prevented any further proceedings in New York up to the present time.

The District Court's order of July 20, 1959.

On July 20, 1959 Judge Ruiz entered the order which was the principal order before the Court of Appeals and which superseded the preceding preliminary orders. This order enjoined Lummus from taking any further action in the New York arbitration proceedings pending a trial of Commonwealth's allegations of fraudulent inducement (R. 331-46). The order contained findings of fact and con-

clusions of law, but Judge Ruiz wrote no opinion. The principal conclusions of the District Court were the conclusion that the issue of fraud in the inducement of the contracts between Lummus and Commonwealth was not an arbitrable issue under the terms of the arbitration agreements and the conclusion that the evidence adduced by Commonwealth raised a "substantial dispute" with respect to the validity and existence of the arbitration agreements. This determination that a substantial dispute existed was, under both the Puerto Rican and the New York statutes, a prerequisite to the conducting of a plenary trial to determine the validity of the arbitration agreements.

The opinion of the Court of Appeals.

On appeal to the United States Court of Appeals for the First Circuit Lummus challenged the order of the District Court on a number of grounds. Neither the issues presented to the Court of Appeals nor the grounds of its decision are made clear in the Petition. Since the issues presented to the Court of Appeals are clearly stated in its opinion, no attempt will be made to detail all of those issues here.*

The issues which the Court of Appeals found to be dispositive of the case went to the merits of Commonwealth's motion for stay of arbitration.

Lummus contended, first, that an arbitration clause is separable from the agreement in which it is embodied. Thus, the question whether the principal agreement was fraudulently induced and may be rescinded is an issue which is arbitrable under an arbitration clause, such as the

* It should be noted that the Court of Appeals found it unnecessary to decide certain issues. (Appendix B, pp. 43-44). If this Court were to grant certiorari and thereafter reverse the decision of the Court of Appeals, it would be necessary to remand the case to the Court of Appeals for determination of these issues.

one involved here, which is broad enough to encompass such an issue. Since all of the issues raised by Commonwealth were arbitrable issues, there was no basis for a stay of the arbitration and it should be permitted to proceed.

Lummus next contended that, even if a claim for rescission based on allegations of fraudulent inducement is not an arbitrable issue, the evidence before the District Court showed that no substantial dispute existed with respect to the question of fraud or the claim for rescission.

The Court of Appeals dealt with these issues with great care and thoroughness.

The Court held that under the New York law, which it was obligated to apply, "an arbitration clause cannot be treated as separable from the other parts of the contract," (Appendix B, page 56), and that fraud going to the principal contract may, therefore, invalidate the arbitration clause. The Court held, however, that "unless, by means of a proper claim of rescission Commonwealth has put in issue the 'making of the contract,' it cannot by merely asserting fraud, stay the arbitration proceeding" (Appendix B, p. 59).

The Court of Appeals found that Commonwealth had not put in issue the making of the contract by means of a proper claim for rescission. Commonwealth's claim was deficient in two respects. First, Commonwealth's conduct prior to and throughout the proceedings demonstrated that it was not making a *bona fide* effort to rescind the contracts between the parties in their entirety. The Court inferred from this conduct, and principally from the fact that Commonwealth obviously had no desire that the parties be restored to their positions prior to the making of the contracts, that the only rescission sought by Commonwealth was of the arbitration clauses themselves. The Court pointed out that a partial rescission of this character is not permissible.

The Court also held that the evidence showed that Commonwealth had unreasonably delayed in manifesting its intent to avoid the contracts and had affirmed the contracts by its words and its actions. As the Court pointed out, Commonwealth called upon Lummus to perform under the contract as late as January, 1959, and "at least implicitly maintained that position until the institution of this suit." (Appendix B, p. 64.)

Nor did Commonwealth point to any recently discovered information which explained the delay in asserting the claim of fraud. Thus the Court pointed out that:

> "Although Commonwealth filed a number of affidavits on the present motions, some of them lengthy, it has not alleged, even in conclusory form, that it acquired any new knowledge later than in the fall of 1957 by means of which it 'discovered' its right to rescind" (Appendix B, p. 65).

The Court referred to "the total absence from the record of any factual, or even conclusory, allegations on this subject" (Appendix B, p. 66). As the Court pointed out:

> "The only thing that the record shows to be newly discovered is an antipathy to arbitration" (Ibid.).

The basis for the decision of the Court of Appeals is well summed up in the following language:

> "If Commonwealth were pursuing with vigor an evident attempt to rescind the principal agreements, and had presented some, even slightly plausible, excuse for not having made its claim sooner, we might be disposed to say that an issue of fact had been made out. Instead, however, after opportunity to make a full presentation there appeared a consistent pattern of an attempt to defeat arbitration by asserting fraud as to the principal agreements, and then seeking to rescind solely the agreements to arbitrate" (Appendix B, p. 66).

The Petition for Rehearing

Commonwealth filed a Petition for Rehearing. The principal argument in the Petition for Rehearing was characterized by the Court of Appeals as "somewhat extraordinary" (Appendix B, p. 71). The Court of Appeals had held that Commonwealth's claim for rescission was deficient, in part, because it was tardily made and there was no evidence that the grounds for rescission had been recently discovered. In its Petition for Rehearing Commonwealth sought to adduce evidence, which had not been adduced below, to the effect that the grounds for rescission had been recently discovered. The Court of Appeals held that it was too late for Commonwealth to supplement the record and refused to receive the affidavits.

Since Commonwealth's affidavits were not received, Lummus has had no opportunity to rebut the allegations of those affidavits. It should be noted, however, that the affidavits themselves reveal that all of the material contained in them was in Commonwealth's possession two months before Commonwealth's action was brought and several months before the record was made in the District Court. Commonwealth nowhere explains why, if the facts alleged in these affidavits were the facts which first persuaded Commonwealth that fraud had been committed and that it had a right to rescind, there was no reference whatever to those facts in Commonwealth's papers in the District Court.

Argument.

The Court of Appeals carefully and accurately applied the principles of local law which are determinative of this controversy. The thoroughness of the Court's opinion and the force of its reasoning demonstrate that no review by this Court is necessary. Moreover, since the issues pre-

sented here turn on questions of local law and analysis of the voluminous record in the District Court, no question appropriate for consideration by this Court is tendered.

Commonwealth's Petition for Certiorari is an exercise in calculated obfuscation. It mingles separate issues in an argumentative *hodge-podge*. An effort is made in this Brief to consider the issues separately and in logical order.

I.

The Court of Appeals made the proper choice of law and, in any event, Petitioner was not prejudiced by that choice of law.

The Petition for Certiorari fails to make it clear that two separate choice-of-law problems were considered by the Court of Appeals.

First, there was the question what test should be applied in determining whether a sufficient basis had been laid for the holding of a plenary trial on the issues raised by the motion to stay arbitration. On this issue the Court of Appeals noted that there was no difference between the Puerto Rican and the New York law and that it was, therefore, unnecessary to choose between them (Appendix B, p. 48). The Court of Appeals pointed out that the Puerto Rican statute provides that the Court may proceed to a full hearing on a dispute as to the validity or existence of an arbitration agreement only if it is shown that a "substantial dispute" exists. The Court pointed out that under the New York statute a "substantial issue" must be raised as to the "making of the contract" in order to warrant a trial of that issue. No difference is discernible between these two tests.

Although the District Court had stated that the Puerto Rican statute was applicable it had pointed to no distinction between that statute and the New York

Indeed, in arguing to the District Court Commonwealth itself stated that there was no difference between the two statutes in this respect. In a memorandum submitted to the District Court Commonwealth described the procedure under the Puerto Rican statute and then stated:

> "The law of New York Civil Practice Act, § 1450 provides essentially the same procedure . . ."*

In arguing orally to the District Court, counsel for Commonwealth also emphasized that the New York and Puerto Rican statutes have the same effect. As he pointed out, motions under 32 L. P. R. A. § 3204 and under § 1450 of the New York Civil Practice Act tender "exactly the same issue. . . ."** Thus there was no disagreement between the Court of Appeals and the District Court, or between either Court and Commonwealth, with respect to this issue.

The second and separate choice-of-law question was what law should be applied in construing the contracts containing the arbitration clauses, in determining the scope of those clauses, and in determining whether the arbitration clauses were separable from the contracts in which they were embodied.

The only bodies of law which have been considered with respect to these questions at any time in these proceedings are the New York law and the federal law.

Lummus suggested in its reply brief in the Court of Appeals that by virtue of the decision in *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F. 2d 402 (2d Cir. 1959), federal law might properly be applied in determining these questions. In a Rejoinder Brief submitted by Common-

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* Plaintiff's Memorandum of Law in Support of Its Motion Set for Hearing June 1, 1959, p. 10.

** Transcript of hearing of June 1, 1959, p. 54.

wealth it was contended that the *Devonshire* case was wrongly decided and state rather than federal law should apply. The Court of Appeals rejected the view of the *Devonshire* case (Appendix B, p. 53, note 9). Thus there is no issue now raised with respect to the question whether federal or state law should apply.* The only question remaining is whether Puerto Rican or New York law should properly be applied in construing the contracts and the arbitration clauses contained therein.

Since Judge Ruiz wrote no opinion in connection with his order of July 20, 1959, he did not explicitly state what law he was applying with respect to these issues. He did, however, accept Commonwealth's contention that the issue of fraud in the inducement of a contract is not arbitrable and cannot be submitted to arbitration. The authority cited by Commonwealth in support of this proposition consisted entirely of New York cases. Judge Magruder, in considering this issue in his opinion supporting the preliminary order which he entered, relied entirely on New York cases (R. 319). In its brief in the Court of Appeals Commonwealth relied exclusively on New York authority and, indeed, cited not a single Puerto Rican case in discussing these issues.

It is in the face of this consistent reliance on New York law by everyone concerned that Commonwealth seeks now to fabricate a conflict of laws question for consideration by this Court. It is immediately apparent that the Court of Appeals did not disregard or ignore a choice of law made by the District Court. On the contrary, there was no significant issue as to which law applied.

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* It should be emphasized that none of the issues tendered by the Petition for Certiorari in *Robert Lawrence Co. v. Devonshire Fabrics, Inc.* is presented here. The first issue presented in *Devonshire* was the question whether federal or state law should be applied—an issue now moot here. The remaining issues in *Devonshire* related to the content of [illegible]
Court [illegible]

Nor does Commonwealth, even in its Petition for Certiorari, point to any difference between the New York and the Puerto Rican substantive law which is relevant to the determination whether or not the arbitration should be stayed. The only difference to which Commonwealth points is with respect to the grounds on which the arbitration award may be set aside (Petition, p. 15).* This of course has nothing to do with the question whether Commonwealth has shown the existence of a substantial dispute sufficient to require a plenary hearing or the question whether the arbitration should be stayed. Since there is no demonstrated difference between the New York and Puerto Rican law, Commonwealth's alleged conflict of laws issue is mere shadow boxing.

Even if there were a conflict of laws issue and even if the choice of law made some difference, it is perfectly apparent that under any relevant conflict of laws principle the Court of Appeals properly applied New York law. The contracts containing the arbitration clauses were negotiated and executed in New York. The parties specified that the arbitration was to take place in New York. The parties specifically indicated their intention that New York law apply by reciting in the agreement that it should be "deemed" made, executed and delivered in New York. In holding that the New York law was applicable the Court of Appeals relied on the Restatement of the Conflict of Laws and on a series of Puerto Rican cases (Appen-

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* Even this difference evaporates upon analysis. Under Section 1462 of the New York Civil Practice Act an arbitration award may be set aside if the arbitrators refuse to hear evidence "pertinent and material to the matter in controversy." *Gervant* v. *New England Fire Insurance Co.*, 306 N. Y. 393, 400, 118 N. E. 2d 574 (1954). It does not appear that this standard is different from the provision of Section 22(c) of the Arbitration Law of Puerto Rico, 32 L. P. R. A. §3222(c), that the award may be set aside where the arbitrators refuse "to hear relevant and material evidence on the dispute. . . ."

dix B, p. 54, footnote 109. Commonwealth, while complaining vociferously that the wrong conflict of laws rule has been applied, suggests no other rule and points to nothing from which such a rule might be inferred.

Commonwealth argues that the action of the Court of Appeals was contrary to this Court's ruling in *Bernhardt v. Polygraphic Company of America*, 350 U. S. 198 (1956) requiring that a District Court apply the conflicts rule of the state in which it sits. In the first place, there is some question whether the rule of the *Bernhardt* case is applicable to a federal court sitting in Puerto Rico since the Rules of Decision Act, 28 U. S. C. 1652, does not apply in territories of the United States. *Waialua Agricultural Co. v. Christian*, 305 U. S. 91, 109 (1938).* Although a federal court is bound to give some deference to the rulings of territorial courts, *Waialua Agricultural Co. v. Christian, supra*, at 109, it is not bound to the local rule where that rule does not relate to matters of "local practice, customs or law." *In re Sawyer*, 360 U. S. 622, 640 (1959). Since the Puerto Rican courts have indicated that they will follow the conflict of laws principles applied in the continental United States, *Cruz v. Dominguez*, 9 P. R. R. 551 (1905); *Colon v. Registrar*, 22 P. R. R. 344 (1915), it can hardly be said that the conflicts rule is a local matter. For the same reason Commonwealth derives little support from the principle requiring a Court of Appeals to give deference to a local court's construction of local law where that law applies. *E.g., De Castro v. Board of Commissioners of San Juan*, 322 U. S. 451 (1944). The District Court has no greater expertise than the Court of Appeals in applying general principles of the conflict of laws. Moreover, Commonwealth

* It is not clear whether Puerto Rico should be regarded as a "territory" for this purpose. *Cf. Mora v. Mejias*, 206 F. 2d 377, 387 (1st Cir. 1953).

ignores this Court's ruling that it will itself defer to determinations of the Courts of Appeals with respect to questions of local law. *E.g., Byrd* v. *Blue Ridge Rural Electric Cooperative, Inc.*, 356 U. S. 525, 529-30 (1958); *rehearing denied*, 357 U. S. 933; *Ragan* v. *Merchants Transfer & Warehouse Co.*, 337 U. S. 530, 534 (1939).

In any event, none of these problems is raised here since the Court of Appeals did not disagree with the District Court as to the conflicts rule to be applied, no substantive law other than the law of New York has ever been cited, and no difference has been shown to exist between the New York and the Puerto Rican law.

II.

The Court of Appeals correctly held that no substantial issue had been raised with respect to the validity of the arbitration agreements.

The Court of Appeals carefully analyzed the New York law which it found to be applicable and carefully examined the record and the findings of the District Court. The Court of Appeals concluded that, in order to avoid arbitration, Commonwealth was required to demonstrate the existence of a substantial issue with respect to the validity of the arbitration agreements. The Court further concluded that such a demonstration required a showing that a bona fide rescission of the contracts containing the arbitration clauses had been sought and that Commonwealth's claim for rescission was at least plausible. In so holding, the Court of Appeals adopted the construction of the New York law which was most favorable to Commonwealth. The Court of Appeals concluded, however, that Commonwealth had failed to raise a substantial issue

because it had made no bona fide claim for rescission and, in any event, rescission was not permissible because of Commonwealth's delay in asserting its claim and its affirmance of the contracts.

Commonwealth's principal attack on the determination of the Court of Appeals is a suggestion that the Court has somehow abused its proper function in reviewing the decision of the District Court.

The Court of Appeals construed the New York law in the way most favorable to Commonwealth.

Lummus argued in the Court of Appeals, as it had in the District Court, that an arbitration clause is separable from the contract in which it is embodied and that where the clause is broad enough to include an allegation of fraud such an allegation is arbitrable even when it is joined with a proper claim for rescission. If the Court of Appeals had accepted this view of the New York authorities, this would have been sufficient to dispose of the case in Lummus' favor.

The Court of Appeals, while it recognized the wisdom of the rule for which Lummus contended, was unable to derive that rule from the New York cases.* It pointed out, however, that even under the New York authorities it was essential for the party seeking to avoid arbitration to join

* Cases decided since the submission of this case to the Court of Appeals indicate that Lummus' view of the New York law is correct and that an arbitration clause should be regarded as separable. For example, in *Fabrex Corp.* v. *Winard Sales Co.*, 200 N. Y. S. 2d 278 (Sup. Ct. N. Y. Co. 1960) the Court said:

> "Where an arbitration clause is broad and all inclusive, a request for rescission, either, in a pending action or in a demand for arbitration, based upon fraud in the inducement, will be left for determination of the arbitrators [citations omitted]." (200 N. Y. S. 2d at 280). See also *Matter of Soriano*, 113 N. Y. L. J. No. 39, p. 14, col. 5 (Sup. Ct. N. Y. Co. Feb. 29, 1960).

with his claim of fraud a proper claim for rescission of the contracts. It is not open to dispute that under the New York authorities the party seeking to stay arbitration must do at least this much. This is clear, for example, from a case such as *Amerotron Corporation* v. *Maxwell Shapiro Woolen Company*, 3 App. Div. 2d 899, 162 N. Y. S. 2d 214 (1st Dep't 1957), *aff'd* 4 N. Y. 2d 722, 148 N. E. 2d 319 (1958).

Commonwealth makes no serious effort to challenge this ruling. It does not, in its Petition, make any effort to discuss the New York cases. Commonwealth limits itself to the suggestion that the "preference" of the Court of Appeals for the rule applied in *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959) led it to hold that "an acknowledged principle of New York law yielded to the court's preferred rule of the severability of arbitration clauses. . . ." (Petition, p. 19). It is, of course, clear that the Court of Appeals did no such thing. It found that this was "not a matter in which we feel free to follow our own views" (Appendix B, p. 53). The Court concluded that it was "clear that New York law must govern" (Appendix B, p. 53) and proceeded to apply that law with great care.

The analysis by the Court of Appeals of the record below was correct.

Nor does Commonwealth make any serious effort to challenge the factual underpinnings of the decision of the Court of Appeals. Rather it argues that it should be given another opportunity to adduce evidence which it failed to adduce in the District Court.

Nowhere does Commonwealth's Petition point to any evidence whatever in the record before the District Court

showing that its claim for rescission was timely or that there was any reason for the long delay which occurred before that claim was asserted. Commonwealth spread on the record the evidence upon which it relied in support of its claim of fraud. That evidence itself demonstrated that all of the facts were known to Commonwealth in 1957. As the Court of Appeals pointed out "the record is bare" as to any occurrence subsequent to November, 1957 which threw any new light on the situation or which could have persuaded Commonwealth that a fraud had been committed (Appendix B, p. 64). Yet it was not until after Lummus had demanded arbitration in April, 1959 that Commonwealth made any claim of rescission or said anything about fraud. As the Court of Appeals also indicated, Commonwealth failed to show even a "slightly plausible" excuse for not having made its claim sooner. The record is abundantly clear that no timely claim of rescission was made.

It is equally apparent that the demand for recission, even when it was made, was inadequate. The Court of Appeals, after a thorough examination of Commonwealth's conduct and of the statements in its brief to the Court of Appeals concluded that Commonwealth had filed a damage action with a "mere claim for partial rescission appended" (Appendix B, p. 60). In denying Commonwealth's Petition for Rehearing the Court pointed out that Commonwealth had made "no serious attempt to refute" its deduction that Commonwealth was not really pursuing a restitutionary remedy and, indeed, found confirmation in the Petition for Rehearing for that deduction (Appendix B, p. 71). Commonwealth, in its Petition to this Court, now makes some effort to contend that the Court of Appeals misread its intention.

Commonwealth suggests that the Court of Appeals must have been wrong because Lummus never read the complaint as the Court of Appeals did. In this Commonwealth errs. For example, in an affidavit filed by counsel for Lummus in opposition to Commonwealth's motion for stay of arbitration the complaint was characterized as involving "essentially a claim for damages *ex delicto*" (R. 150). Similarly, in arguing before the District Court on June 1, 1959 counsel for Lummus stated that:

> "... what this court has before it is primarily an action for damages."*

In the same vein, counsel for Commonwealth stated:

> "The question before this Court in this proceeding is essentially a question of tort."**

The Court of Appeals correctly concluded that Commonwealth had not sought and was not seeking a rescission of the entire contracts and a restoration of both parties to their positions prior to the execution of the contracts.

It is submitted that the record amply supports the conclusion of the Court of Appeals that Commonwealth's conduct was the result of "an antipathy to arbitration" and that Commonwealth failed to raise a bona fide and substantial issue with respect to the validity of the arbitration agreements (Appendix B, p. 66).

The Court of Appeals did not interfere with any exercise of discretion by the District Court.

Commonwealth suggests that the Court of Appeals in some way interfered in an improper way with an exercise of discretion by the District Court. Thus Commonwealth

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* Transcript of June 1, 1959, p. 32.

** Transcript of June 1, 1959, p. 50.

characterizes the District Court's decision as "discretionary" (Petition, p. 20). Commonwealth goes on to suggest that the Court of Appeals first held that the District Court had not abused its discretion and then "invaded" the discretion of the District Court and rendered a decision "repugnant" to its own earlier determination that no abuse of discretion existed (Petition, p. 21).

In making this argument Commonwealth confuses two separate determinations which the Court of Appeals made. The Court of Appeals first considered whether the District Court had abused its discretion in determining that the motion to stay arbitration pending in Puerto Rico should be allowed to proceed and the action to compel arbitration pending in New York should be stayed. This was a question which had nothing to do with the merits of the motion to stay arbitration. It was merely a question which of two pending federal suits should be allowed to proceed. If the Court of Appeals had found an abuse of discretion, it would have been unnecessary to consider at all the merits of Commonwealth's motion for stay of arbitration. Although the Court of Appeals found that "there were sufficient reasons which would have justified . . . [the District Court] as a matter of discretion, in staying its own proceedings in favor of those in New York" (Appendix B; p. 43), the Court of Appeals held that there was no abuse by the District Court of its discretion.

Having made this determination, the Court proceeded to the merits of Commonwealth's motion to stay. Here there was no question of discretion involved. Under both the New York and Puerto Rican statutes Commonwealth was required to make an affirmative showing that a substantial dispute existed with respect to the validity of the arbitration clauses before a plenary hearing on this issue could be held. Unless there was a sufficient basis for the

holding of a plenary hearing, there could, of course, be no ground for the issuance of a preliminary injunction pending such a hearing.

The Court of Appeals therefore considered the legal question whether the District Court's determination that a substantial dispute existed was correct.* It held that no substantial dispute existed and thus disposed of the motion to stay on the merits. This disposition was in no way contrary to the Court's earlier determination that the District Court had not abused its discretion in entertaining the motion.

The Court of Appeals did not infringe upon the fact-finding function of the District Court.

Commonwealth next suggests that the reversal by the Court of Appeals of the District Court's ruling that a substantial dispute existed somehow impaired or infringed upon the fact-finding role of the District Court. It is apparent that there was no such impairment or infringement.

The issues with respect to which the District Court and the Court of Appeals differed were not issues of fact, but

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* At pages 23 and 24 of the Petition, Commonwealth cites a long list of cases for the proposition that the issuance of a preliminary injunction is a matter resting within the discretion of the District Court. Although this principle is sound, it does not deprive the Court of Appeals of the power to consider whether the issuance of the preliminary injunction was based upon an error of law or an error in applying the law to the facts. Thus in *W. A. Mack Inc.* v. *General Motors Corporation*, 260 F. 2d 886, 890 (7th Cir. 1958), relied on by Commonwealth, the Court of Appeals considered whether the complaint in the action made out a *prima facie* case. See also, *e.g.*, *Clemons* v. *Board of Education of Hillsboro*, 228 F. 2d 853, 857-58 (6th Cir. 1956), *cert. denied*, 350 U. S. 1006 (1956); *Mitchell* v. *Raines*, 238 F. 2d 186 (5th Cir. 1956); *In re Central Railroad Co. of New Jersey*, 163 F. 2d 44, 53 (3rd Cir. 1947), *cert. denied, sub nom. Gardner* v. *State of New Jersey*, 332 U. S. 810; *Booth* v. *United States*, 154 F. 2d 73 (9th Cir. 1946); *Ring* v. *Spina*, 148 F. 2d 647, 650 (2d Cir. 1945), *cert. denied*, 335 U. S. 813 (1948).

were rather questions with respect to the application to the facts of relevant legal principles. The requirement of Rule 52 that findings of a District Court be set aside only when "clearly erroneous" does not apply to mixed questions of fact and law or to determinations of the legal significance of evidentiary facts. *E.g., United States* v. *United States Gypsum Co.*, 333 U. S. 364, 396 (1948); *Lehmann* v. *Acheson*, 206 F. 2d 592, 594 (3rd Cir. 1953); *Stevenot* v. *Norberg*, 210 F. 2d 615, 619 (9th Cir. 1954).

The Court of Appeals accepted the factual findings of the District Court, rejecting only its ultimate conclusion that a substantial dispute had arisen with respect to the validity and existence of the arbitration agreements. Although the Court of Appeals expressed some skepticism with respect to these findings (Appendix B, pp. 49-50), it was unwilling to set them aside. The Court of Appeals held, however, that neither these findings nor the evidence submitted by Commonwealth showed the existence of a substantial dispute. Rather the record clearly demonstrated that, since Commonwealth was not seeking a complete rescission and had not made a timely claim for rescission, a substantial dispute did not exist.

Even if it were assumed that some additional findings by the District Court might have been helpful to the Court of Appeals in considering the case, it would not follow that the absence of those findings precluded a final disposition of the matter by the Court of Appeals. It is clear that, even where findings are omitted, the Court of Appeals may retain and dispose of the case rather than remanding it for further findings. *E.g., Yanish* v. *Barber*, 232 F. 2d 939, 947 (9th Cir. 1956); *Food Fair Stores, Inc.* v. *Square Deal Market Co., Inc.*, 206 F. 2d 482, 484, note 3 (D. C. Cir. 1953), *cert. denied*, 346 U. S. 937 (1954); *Westley* v. *Southern*

Railway Co., 250 F. 2d 188, 189 (4th Cir. 1957), *rehearing denied*, 252 F. 2d 79 (1958); *Smith* v. *Dravo Corp.*, 208 F. 2d 388, 391-92 (7th Cir. 1953).

The findings and conclusions of the District Court were adequate to give the Court of Appeals a full understanding of the questions involved. The decision of the Court of Appeals did not turn on any weighing of contradictory evidence, but rather on the failure of Commonwealth to seek a true rescission, the failure of Commonwealth to suggest any plausible reason for delay in demanding rescission, and undisputed facts in the record showing that all of the information upon which Commonwealth relied in asserting its claim of fraud had been in Commonwealth's possession over a long period of time. Under these circumstances it is plain that no further findings were necessary.*

The Court of Appeals properly refused to give Commonwealth a second opportunity to prove its case.

Commonwealth's next argument is that since it failed in its first effort to prove the existence of a substantial dispute with respect to the validity of the arbitration agreements, it should now be given a second chance. No persuasive reason appears, however, why such a second chance should be afforded to it.

In arguing that it is entitled to another opportunity to prove its case Commonwealth relies on cases like *Fountain*

* The cases cited by Commonwealth are not to the contrary. *Sartor* v. *Arkansas Natural Gas Corp.*, 321 U. S. 620 (1944) and *Kennedy* v. *Silas Mason Co.*, 334 U. S. 249 (1948), cited at p. 27 of the Petition, have nothing to do with the circumstances under which a case must be remanded for further findings. Both of those cases dealt only with the circumstances under which a summary judgment may be granted. The *Sartor* case, for example, stands only for the familiar proposition that a summary judgment may not be granted on the basis of inconclusive affidavits by interested witnesses.

v. *Filson*, 336 U. S. 681 (1949) (Petition, p. 23) and *Byrd* v. *Blue Ridge Rural Electric Cooperative, Inc.*, 356 U. S. 525 (1958) (Petition, p. 22). Those cases have no application. There a party had been deprived of the opportunity to submit evidence on a particular issue because of a preliminary ruling in his favor which made such proof unnecessary. Of course this Court held that, when the legal ruling in his favor was reversed, the party must be afforded an opportunity to submit evidence on the remaining factual issue, before it was resolved against him.

Commonwealth suggests that the District Court here "deferred consideration" of the issue of the timeliness of Commonwealth's claim and that there was a "void in the record" with respect to that issue (Petition, p. 21).

It is clear, however, that Commonwealth has had a full opportunity to submit evidence on every question relevant to the determination whether a substantial dispute existed. Inspection of the order of the District Court reveals that the Court did not defer for a later hearing the issue whether Commonwealth had made a timely demand for rescission. Indeed, it had no power to do so. Under the applicable statute the Court could conduct a plenary hearing on the motion for stay of arbitration only after it had first determined that a substantial dispute had been shown to exist. It would be beyond its power to order a plenary hearing without finally determining whether there was a substantial dispute and ruling on every subsidiary issue relevant to that determination.

Nor was there a void in the record. Lummus introduced uncontradicted documentary evidence which affirmatively proved that Commonwealth had affirmed the contracts. The proof submitted by Commonwealth itself demonstrated that all of the facts relied upon in support of the claim of fraud had long been in its possession. The

record was complete and clear. Commonwealth's only objection to that record is that it does not prove what Commonwealth would like it to prove.

Until the filing of the Petition for Rehearing in the Court of Appeals Commonwealth had assumed that the record was complete and had argued on the basis of that record that its claim of rescission was proper and timely. Thus in its brief in the Court of Appeals Commonwealth pointed to facts in the record upon which it based an argument that the alleged fraud was recently discovered and the claim for rescission promptly made.* The Court of Appeals accurately noted in denying the Petition for Rehearing that:

> "... Commonwealth's original brief did not suggest that this issue was not ripe, but contended, quite ineffectually, that the record was adequate" (Appendix B, p. 72).

The Court of Appeals properly refused to receive Commonwealth's tender of proof.

Finally, Commonwealth urges that, if it is not entitled to retry its motion before the District Court, it should be permitted to do so by the submission of affidavits to the Court of Appeals.

It is, of course, clear that the record in a case must be closed sometime and that the submission of new evidence in the Court of Appeals cannot be countenanced.

It is too well settled to require extensive argument that new evidence may not properly be submitted for the first time on appeal. *E.g., Brown* v. *Wilson & Company*, 239 F. 2d 280 (7th Cir. 1956). The impropriety of such a

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*Brief for Plaintiff-Appellee on Consolidated Appeals, pp. 44-45.

tender of proof is even more apparent where it occurs on Petition for Rehearing after the Court of Appeals has already disposed of the case. *Jones v. Zurich Gen. Acc. & Liab. Ins. Company*, 121 F. 2d 761, 764 (2d Cir. 1941).

The only authority cited by Commonwealth in urging the Court of Appeals to accept this new evidence was *Norris v. Alabama*, 294 U. S. 587, 593, note 1 (1935) (R. 42b). That case is completely irrelevant since the Court there merely allowed the production on the argument of certain jury rolls which had been in the record before the lower court.

Commonwealth is not entitled to retry its motion either in the District Court or in the Court of Appeals.

III.

The Court of Appeals properly instructed the District Court to stay further proceedings pending termination of the arbitration.

Finally, passing from its objections to that portion of the decision of the Court of Appeals which set aside the District Court's preliminary injunction, Commonwealth objects to the instruction by the Court of Appeals that the District Court stay its further proceedings pending termination of the arbitration.

Commonwealth first seeks to suggest that there is some inconsistency between this instruction and the determination of the Court of Appeals that the District Court had not abused its discretion in entertaining the motion for stay. Thus Commonwealth argues at length, at pages 17 and 18 of its Petition that the Court of Appeals found no error in the District Court's exercise of its discretion and that the subsequent instruction to the District Court to stay its proceedings was in conflict with this

court's ruling in *Kerotest Mfg. Co. v. C-O-TWO Fire Equipment Co.*, 342 U. S. 180 (1952).

Again Commonwealth confuses two distinct determinations. Applying the rule of the *Kerotest* case, the Court of Appeals found that the District Court had not abused its discretion in entertaining the motion for a stay of arbitration. The Court of Appeals then considered the motion for a stay on its merits and determined that no ground for a stay of arbitration had been shown. The result of this determination was, of course, that the arbitration should be allowed to proceed. The only remaining question was what court should assume jurisdiction with respect to any further judicially cognizable questions which arose in the course of the arbitration. The decision of the Court of Appeals on this question was unquestionably correct.

There has never at any time been any suggestion that, if the arbitration proceeds, the District Court in Puerto Rico should have any jurisdiction to supervise it. Indeed, Lummus argued to the Court of Appeals that, since the parties had agreed that the arbitration would take place in New York, the District Court in Puerto Rico was without jurisdiction even to order the arbitration stayed. *E.g., Marchant v. Mead-Morrison Mfg. Co.*, 352 N. Y. 284, 290 (1929); *Amazon Cotton Mills Co. v. The Duplan Corp.*, 245 N. C. 496, 96 S. E. 2d 267 (1957), *petition for rehearing dismissed*, 246 N. C. 88, 97 S. E. 2d 449. This was one of the questions which the Court of Appeals found it unnecessary to decide. Even if it were assumed that a court has jurisdiction to stay an arbitration which is to take place in another jurisdiction, it would not follow that the Court has power to supervise such an arbitration once it has been determined that the arbitration should be permitted to proceed. The impropriety of such extraterritorial supervision of the arbitration is obvious.

Commonwealth's argument assumes that it has some essential right that the arbitration be governed by the Puerto Rican arbitration statute and supervised by the Puerto Rican Court. This assumption is extraordinary indeed in the face of contracts by which the parties specifically agreed that the arbitration was to take place in New York.

Conclusion.

The decision of the Court of Appeals was based on a thorough analysis of the record in this case and an accurate application of the relevant legal principles. No issue is presented which is appropriate for consideration by this Court. It is submitted that the decision was in all respects correct and the Petition for Certiorari should be denied.

Respectfully submitted,

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